CHUNG KHIAW BANK LTD.

v.

HOTEL RASA SAYANG SDN. BHD. & ANOR.

SUPREME COURT, KUALA LUMPUR
HASHIM YEOP SANI CJ (MALAYA)
HARUN HASHIM SCJ
AJAIB SINGH SCJ
[CIVIL APPEAL NO. 326 OF 1988]
3 JANUARY 1990

CONTRACT: *Illegality - Loan granted in contravention of s. 67 of the Companies Act - Void and unenforceable - Object of s. 67 - Whether other securities taken as part of the grant of loan also void and unenforceable - Whether subsequent loan part of which was used to pay the first loan also tainted with illegality - Whether doctrine of severance applied - Section 24 of the Contracts Act whether applicable - Whether Court can look at the trend of other common law countries - Section 3 of the Civil Law Act.*

CIVIL PROCEDURE: *Appeal - Whether arguments can be brought on points not pleaded and raised in the Court below.*

The appellant ("the bank") had by a letter dated 29 October 1980 granted a loan of RM1.25 million to one Syarikat Johor Tenggara Sdn. Bhd. ("JT company") ("the first loan") to facilitate the purchase by persons named Ow and Chee of the shares in the 1st respondent company ("the hotel") upon the following security:

(a) charge over land owned by hotel;

(b) debenture over the hotel's assets;

(c) guarantees from the directors of JT company; and

(d) guarantee from Chee.

The first loan was embodied in an agreement dated 19 November 1980 and the bank disbursed the first loan.

Later, on 28 September 1982 the bank granted an overdraft facility and a further loan of RM2.5 million to the bank ("the second loan") upon the following securities:

(a) charge over the same land owned by the hotel;

(b) debenture over the hotel's assets;

(c) guarantees from the directors of the hotel; and

(d) charge over another piece of land owned by the 2nd respondent (2nd respondent is a subsidiary of the hotel).

It was a term of the second loan that the first loan shall be liquidated upon release of the term loan portion of the second loan.

The charges pursuant to the second loan were duly registered.

The bank sued the hotel, Upaya and the guarantors under the terms of the second loan. The bank also commenced foreclosure actions and all actions were consolidated and tried together.

The respondent raised the issue of illegality of the first and second loans and this issue was agreed to be tried as a preliminary issue.

The question of illegality was based on s. 67 of the Companies Act - i.e., that the first loan was illegal under s. 67(4) (now s. 67(6) of the Companies Act) as by the grant of this loan the hotel had assisted in the financing of the purchase of its own shares by providing security for the same. As part of the second loan was used to pay off the first loan, the second loan was also illegal.

The trial Judge found in favour of the respondents and ordered that the appellants claims be dismissed and all securities taken be cancelled.

The appellants appealed. At the appeal two broad questions were raised:

(a) whether the first loan was void being a contract prohibited by statute or a contract entered into to defeat the objects of a statute - s. 24(d) of the Contracts Act; and

(b) whether the second loan was tainted with illegality and should not be enforced.

The appellants framed their arguments as follows:

(a) there is nothing in the said s. 67(4) (s. 67(6) now) to suggest that contravention of s. 67(1) would have the consequence of rendering the loan given in the circumstances irrevocable and the security given as unenforceable;

(b) Section 24 of the Contracts Act has no application in this case;

(c) the trend in common law is to save rather than strike down commercial contracts;

(d) the doctrine of severance applies to save the second loan.

Held:

[1] What is prohibited by s. 67 of the Companies Act is for a company to give directly or indirectly whether by means of a loan, guarantee or security or otherwise any financial assistance for the purpose of or in connection with the purchase or subscription of any shares in the company of where a company is a subsidiary in its holding company. It is a widely worded provision - any financial assistance, whether directly or indirectly with the object of dealing in the shares of a company or its holding company is prohibited.

[2] It is clear from the documents that the first loan was in contravention of s. 67 of the Companies Act.

[3] As a general principle, a contract, the making of which is prohibited by statute expressly or by implication, shall be void and unenforceable unless the statute itself saves the contract or there are contrary intentions which can reasonably be read from the language of the statute itself.

[4] In considering illegality under the common law the question of public policy is often considered.

[5] However, the Courts in this country are bound by the provisions of s. 24 of the Contracts Act which *inter-alia* deals with what is forbidden or prohibited by law. Section 24 is explicit and must be applied by the Courts.

[6] Section 24 may have originated from some old common law provisions but the principle has now been converted to a statutory provision.

[7] On account of s. 3 of the Civil Law Act the development of the common law (for the States of Malaya) after 3 April 1956 is entirely in the hands of the Courts of this country - we cannot just accept the development of the common law in England.

[8] On account of the above, the Court rejects the argument that the Courts here must follow the "trend" shown by the Courts in other common law countries to be slow in striking down illegal transactions.

[9] Paragraphs (a) - (b) and (e) of s. 24 of the Contracts Act should be read disjunctively.

[10] the primary object of s. 67 is to protect the company and no one else and is designed to prevent the assets of a company from being misused.

[11] The appellant here had knowledge of the illegality - the bank was fully aware of the nature of the transactions.

[12] the first and second loans should be regarded as one continuous transaction. As the first loan was prohibited by statute, the second loan is tainted with illegality.

[13] On the question of severance, two principles would seem to have been established:

(a) each case must be considered on its own merits; and

(b) each case depends on its own circumstances and on the nature of the illegality itself;

[14] However, as the point on severance was not pleaded and not argued in the Court below the appellants cannot now proceed to argue the same.

[Appeal dismissed. Each party to bear its own costs.]

Cases referred to:
Wai Hin Tin Mining Co. Ltd. v. Lee Chow Beng [1968] 2 MLJ 251
Scott v. Brown, Doering, McNab & Co. [1892] 2 QB 724
Trevor & Anor. v. Whitworth & Anor. [1887] 12 AC 409
Mookapillai & Anor. v. Sri Saringgit Sdn. Bhd. & Ors. [1981] 2 MLJ 114
Phoenix Insurance v. Adas [1987] 2 All ER 152
Yango Pastoral Co. Pty. Ltd. v. First Chicago Australia Ltd. [1978] 139 CLR 410
Menaka v. Lum Kum Chum [1977] 1 MLJ 91
Cope v. Rowlands [1836] 2 M & W 149
Vita Food Products Inc. v. Unus Shipping Co. Ltd. [1939] 1 All ER 513
Government of Malaysia v. Lim Kit Siang [1988] 2 MLJ 12, [1988] 1 CLJ (Rep) 63
Wallersteiner v. Moir [1974] 3 All ER 238
Re VGM Holdings Ltd. [1942] 1 All ER 225
Carney v. Herbert [1985] 1 All ER 438
Muniandy & Anor. v. Muhammad Abdul Kader & Ors. [1989] 2 MLJ 418
Firm, Pratapchand v. Firm, Kotrike [1975] AIR SC 1223
Patriot Pte. Ltd. v. Lam Hong Commercial Co. [1980] 1 MLJ 135

Legislation referred to:
Companies Act 1961 [Aus], s. 67
Contracts Act 1950, s. 24
Companies Act 1965, ss. 67, (1), (6)
Companies Ordinance 1940, ss. 47, 48
Contracts (Malay States) Ordinance 1950, s. 2(g)
Civil Law Act 1956, s. 3
Companies Act 1948 [UK] ss. 54, (1)
Contract Act [Ind], s. 23
Moneylenders Ordinance 1951, s. 8(b), (c)

Other source referred to:
Chitty on Contracts, Vol. I, 23rd Edn., at para. 808

For the appellants - James Puthucheary, Martin Cheah with him; M/s. Skrine & Co.
For the respondents - K.H. Choo; M/s. K.H. Choo & Co.

JUDGMENT

Hashim Yeop Sani CJ (Malaya):

By a letter dated 29 October 1980 (A.R. Vol. 2, p. 232) the appellants ("the bank") acceded to the request of a company, Syarikat Johor Tenggara Sdn. Bhd., for a fixed loan of RM1,250,000 to facilitate the purchase (by Ow Chor Seng and Chee Eng Hoon, the directors) of the shares of Hotel Rasa Sayang Sdn. Bhd. ("the hotel"). This fixed loan was to be secured by:

(a) a first legal charge on Malay Grant 1969 on Lot 1327 situated in the township of Johor Bahru of which the hotel was the registered proprietor;

(b) a debenture stamped up to RM1,250,000 on all the hotel's assets;

(c) joint and several guarantees for RM1,250,000 from the directors of Syarikat Johor Tenggara Sdn. Bhd.; and

(d) a personal guarantee from Chee Eng Hock for the same amount of RM1,250,000.

An agreement for this purpose was entered into on 19 November 1980 by the parties concerned. The hotel executed the securities and the bank disbursed the loan.

On 28 September 1982 the bank granted an overdraft facility and a further loan of RM2,500,000 to the hotel secured by a first legal charge for an amount up to RM4,000,000 over the hotel's land and a further first legal supplementary charge of the same sum on land comprised in Grant No. 753 for Lot No. 218 situated also in the township of Johor Bahru owned by Upaya Ladang Koko Sdn. Bhd., a subsidiary company of the hotel. As further security for the term loan the hotel was to issue a debenture in favour of the bank over its property and undertaking and also to obtain joint and several guarantees secured from all the directors.

One of the "terms and conditions" stipulated in the bank's letter of 28 September 1982 was:

> 1. The term loan of RM1,250,000 extended to Syarikat Johor Tenggara Sdn. Bhd. is to be liquidated upon release of the term loan granted under Hotel Rasa Sayang. (AR Vol. 2, p. 236).

The first legal charge was registered under Presentation No. 20275/82 Vol. 1098 Folio 60 on 6 October 1982 where it was stated that the hotel charged its land to the bank to secure the repayment on demand of banking facilities up to the limit of RM4,000,000 which limit includes overdraft facilities to an amount not exceeding RM1,500,000 and a fixed loan to an amount not exceeding RM2,500,000 both with interests.

The first legal supplemental charge was registered under Presentation No. 20276/82 Vol. 1098 Folio 61 on 6 October 1982 where Upaya Ladang Koko Sdn. Bhd., the subsidiary of the hotel, charged its land to the bank to secure the repayment on demand of banking facilities advanced to the hotel as aforesaid.

Proceedings in the High Court against the hotel commenced with civil suit no. 23-1086 of 1989 which was the main action by the bank against the hotel to recover the sum of RM3,785,000.39 and interests thereon. Civil suit no. 23-1085 of 1986 was against Ow Chor

Seng, Choo Yoon Kian, Lim Chea Ngee and Chee Eng Hoon to recover the same said sum of RM3,785,000.39 based on a document of guarantee dated 2 October 1982.

The bank also took several actions to realise the securities provided by the hotel in the following proceedings:

(a) By originating summons no. 31-213-1986 against the hotel and Upaya Ladang Koko Sdn. Bhd. to enforce the charges.

(b) By writ of summons no. 23-1086-86 to enforce the debenture.

(c) By writ of summons no. 23-1085-86 against the guarantors.

On 8 December 1987 the trial Judge granted an order to consolidate the cases. After the consolidation order all the cases went for trial on 22 December 1987.

At the commencement of the trial on 22 December 1987 the issue of the alleged illegality of both the 1980 and 1982 loans granted by the bank was agreed upon to be tried as a preliminary question of law.

After hearing submissions and considering the affidavits and documents produced the trial Judge held that:

(a) The documents evidencing the loans showed that the purpose of the loan RM1,250,000 extended to Syarikat Johor Tenggara on 29 October 1980 was to finance the purchase of the whole of the share equity in the hotel by Syarikat Johor Tenggara and the security for the loan was property belonging to the hotel itself.

(b) On the documents produced there was no doubt that the hotel had given financial assistance contravening s. 67 of the Companies Act 1965 by way of providing security in connection with the purchase of shares in the company (the hotel) itself.

(c) Part of the 1982 loan was to be used to pay off what was outstanding on the fixed loan and therefore the whole of the term loan was illegal.

(d) In s. 67(6) the word "company" refers to the same company as in subsection (1) and not the bank and therefore that provision was of no assistance to the bank in recovering the loan.

The learned Judge then granted the following orders:

(a) dismissing the claims of the bank with costs;

(b) ordering that the guarantee documents be expunged from the record and returned to the defendants;

(c) ordering that the documents of titles pertaining to Malay Grant No. 1569 for Lot 1327 and Malay Grant No. 753 for Lot 218 be delivered up to the respondents and the charges registered on them be discharged and all memorials cancelled; and

(d) ordering that the debentures pertaining to the loan in respect of the respondent's properties be returned and expunged.

From his grounds of decision it would appear quite clearly that the learned Judge decided solely on the loan and security documents before him and the affidavits filed. He stated his findings as follows:

On these evidence, I find that the documents speak for themselves. It seems clear that the purpose of the original loan of RM1,250,000 extended by the plaintiffs to Syarikat Johor Tenggara on 29 October 1980 was to finance Syarikat Johor Tenggara to purchase the whole of share equity in the Hotel Rasa Sayang and the security for this loan was the property belonging to the hotel itself.

Additional security in the nature of guarantees at items (iii) and (iv) of the letter at OCS2 requiring personal guarantees by Ow Chor Seng and Chee Eng Hoon seems to indicate that the earlier purchase of the hotel on 11 October 1980 by these two persons were made on behalf of Syarikat Johor Tenggara as its nominees. This is made clear by the loan agreement executed between the plaintiffs and Syarikat Johor Tenggara on 19 November 1980 at Exhibit OCS2 annexed to Ow Chor Seng's affidavit of 20 January 1987.

The learned Judge set down the relevant events in the chronological order as follows.

(1) On 19 November 1980 the hotel executed a debenture in favour of the bank charging all its properties to the bank to finance the purchase of its equity shares.

(2) On 25 November 1980 the various vendors in the agreement of 11 October 1980 transferred their shares to Syarikat Johor Tenggara.

(3) On 23 December 1980 share certificates in all the equity shares of the hotel were registered in favour of Syarikat Johor Tenggara.

(4) On 28 September 1982 the bank further extended credit facilities to the hotel for a sum of RM4,000,000 upon the same securities of the hotel's assets; one of the terms was that RM1,250,000 was to repay for Syarikat Johor Tenggara's earlier debt to the bank.

On the 1982 loan the learned Judge concluded as follows:

The second loan was granted by the plaintiffs to Hotel Rasa Sayang on 28 September 1982 for the sums of RM1.5 million in overdraft and RM2.5 million as term loan to be secured on the same properties as the first loan on the hotel's properties and assets to be stamped up to RM4 million. The specific term and condition of this loan was that the earlier loan of RM1.25 million extended to Syarikat Johor Tenggara was to be settled upon release of the present loan to Hotel Rasa Sayang - Exhibit OCD3 to encl. (13). In view, this transaction is equally affected by illegality.

It is quite clear to us that the present appeal centered on two broad questions, firstly whether the 1980 loan agreement is void for being a contract prohibited by statute or a contract entered to defeat the object of statute and secondly, whether the 1982 loan agreement is tainted with illegality and therefore should not be enforced.

The crux of the submissions of the bank before us may be summarised as follows:

(a) There is nothing in s. 67(4) (now s. 67(6) of the Companies Act 1965, upon its true and proper construction to suggest that financial assistance in contravention of s. 67(1) in Malaysia would have the consequence of rendering a loan given in the circumstances irrecoverable and any security given by the company or its directors being void and unenforceable.

(b) Section 24 of the Contracts Act 1950 has no application in these circumstances.

(c) Alternatively, the trend in common law countries now is to save commercial contracts and not to strike them down.

(d) If all these contentions are rejected, then the bank further submits that the actual loans, the guarantees and part of the security for the subsequent loans are still enforceable, applying the doctrine of severance.

The crucial issue in the appeal is therefore the effect of s. 67 of the Companies Act 1965. For convenience we reproduce below the relevant parts which read as follows:

> 67(1) Except as is otherwise expressly provided by this act no company shall give, **whether directly or indirectly** and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase deal in or lend money on its own shares.
>
> (2) -
>
> (3) If there is any contravention of this section, the company is, notwithstanding s. 369, not guilty of an offence but each officer who is in default shall be guilty of an offence against this act.
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> Penalty: Imprisonment for two years or ten thousand ringgit or both.

To arrive at the real purport and intent of this section *Wai Hin Tin Mining Co. Ltd. v. Lee Chow Beng* [1968] 2 MLJ 251 would make a good starting point. In that case Chang Min Tat J (as he then was) was also concerned with the effect of s. 67 of the Companies Act 1965. The plaintiff company there claimed for repayment of an interest free loan to the defendant at the lender's request to enable him to pay for the purchase of shares in the plaintiff company. However in the course of the trial the Judge found the whole action by the plaintiff company was based on illegality. The transaction was in violation of an article of the plaintiff company's articles of association and also in breach of s. 47 and s. 48 of the repealed Companies Ordinance 1940. Those two sections of the old ordinance, the predecessor to the Companies Act 1965, prohibited the use of the funds of a company for the purchase of shares of the company, and the company shall not except as authorised by the ordinance "give any financial assistance for the purpose of or in connection with any purchase of shares in the company."

Since the plaintiff company's action did not come within any of the exceptions mentioned in s. 48 of the Ordinance the transaction was held to be unlawful. The plaintiff company's action was dismissed by the learned Judge following an old authority on the enforcement of an illegal contract as stated by Lindley LJ in *Scott v. Brown, Doering, McNab & Co.* [1892] 2 QB 724:

> *Ex turpi causa non oritur actio*. This old and well-known legal maxim is founded in good sense, and expresses a clear and well-recognised legal principle, which is not confined to indictable offenses. No Court ought to enforce an illegal contract or allow itself to be made the instrument of enforcing obligations alleged to arise out of a contract or transaction which is illegal, if the illegality is duly brought to the notice of the Court, and if the person invoking the aid of the Court is himself implicated in the illegality. It matters not whether the defendant has pleaded the illegality or whether he has not. If the evidence adduced by the plaintiff proves the illegality the Court ought not to assist him. If authority is wanted for this proposition, it will be found in the well-known judgment of Lord Mansfield in *Holman v. Johnson.* (Cowp. 343)

Section 48 of the old Companies Ordinance provided that it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase made by any person of any shares in the company followed by certain exceptions. The repealed Ordinance did not however have a clause similar to subsection (6) of the present s. 67 of the Companies Act.

In the explanatory statement in the bill form of the Companies Act before Parliament cl. 67 was explained as follows:

> Clause 67 prohibits a company from dealing in its own shares and from giving financial assistance to anyone dealing in those shares. It covers the same matters as ss. 47 and 48 of the existing legislation but in a much broader fashion. Sub-clause (4) is designed to preserve the right of the company to recover loans made in contravention of the provisions of this clause. It is suggested that it is wrong to punish the company and therefore the shareholders because of the default of the company's officers.

It need not be stressed that what is prohibited by s. 67 of the Companies Act is for a company to give **directly or indirectly** whether by means of a loan, guarantee or security or otherwise any financial assistance for the purpose of or in connection with the purchase or subscription of any shares in the company or where a company is a subsidiary in its holding company. It is a widely worded prohibition. In other words any financial assistance (directly or indirectly) with the object of dealing in the shares of the company or its holding company is prohibited.

The legislative thinking contained in ss. 47 and 48 of the old Ordinance, the predecessor to the present s. 67 of the Companies Act 1965, in fact carried the rule laid down by the House of Lords nearly a century ago in *Trevor & Anor. v. Whitworth & Anor.* [1887] 12 AC 409 against a company dealing in its own shares. This thinking was adopted by our Courts in *Mookapillai & Anor. v. Sri Saringgit Sdn. Bhd. & Ors.* [1981] 2 MLJ 114.

Looking at the documents we agree with the learned Judge in this case that the documents here speak for themselves. We also agree that the original loan in 1980 was clearly a contravention of s. 67 of the Companies Act. This was in fact conceded by Mr. Puthucheary for the bank.

The next question is the effect on a contract where it is prohibited by statute. In *Phoenix Insurance v. Adas* [1987] 2 All ER 152 the Court of Appeal was concerned with the question of illegality of certain insurance and reinsurance contracts. Kerr LJ dealt with the question of illegality as follows:

> The next point is then that it is settled law that any contract which is prohibited by statute, either expressly or by implication, is illegal and void. The leading old authority is the judgment of the Court of Exchequer delivered by Parke B in *Cope v. Rowlands* [1836] 2 M & W 149, 150 ER 707. The relevant statutory provision prohibited any unauthorised person from 'acting as a broker' within the City of London. It was held that an otherwise valid brokerage contract made by an unauthorised person was illegal and void. Since the statute in that case did not contain any reference to contracts, Parke B said (2 M & W 149 at 157, 150 ER 707 at 710):
>
> > It is perfectly settled, that where the contract which the plaintiff seeks to enforce ... is express or implied, is expressly or by implication forbidden by the common or statute law, no Court will lend its assistance to give it effect. It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies a prohibition ... And it may be safely laid down, notwithstanding some *dicta* apparently to the contrary, that if the contract be rendered illegal, it can make no difference, in point of law, whether the statute which makes it so has in view the protection of the revenue, or any other object. The sole question is, whether the statute means to prohibit the contract?

Later in his judgment Kerr LJ adverted to the judgment of the High Court of Australia in *Yango Pastoral Co. Pty Ltd. v. First Chicago Australia Ltd.* [1978] 139 CLR 410 where Gibbs ACJ said:

> It is often said that a contract expressly or impliedly prohibited by statute is void and unenforceable. That statement is true as a general rule, but for complete accuracy it needs qualification, because it is possible for a statute in terms to prohibit a contract and yet to provide, expressly or impliedly, that the contract will be valid and enforceable. However, cases are likely to be rare in which a statute prohibits a contract but nevertheless reveals an intention that it shall be valid and enforceable, and in most cases it is sufficient to say, as has been said in many cases of authority, that the test is whether the contract is prohibited by the statute. Where a statute imposes a penalty upon the making or performance of a contract, it is a question of construction whether the statute intends to prohibit the contract in this sense, that is, to render it void and unenforceable, or whether it intends only that the penalty for which it provides shall be inflicted if the contract is made or performed.

And Mason J said:

> The principle that a contract the making of which is expressly or impliedly prohibited by statute is illegal and void is one of long standing but it has always been recognized that the principle is necessarily subject to any contrary intention manifested by the statute. It is perhaps more accurate to say that the question whether a contract prohibited by statute is void is, like the associated the contract, a question of statutory construction and that the principle to which I have referred does no more than enunciate the ordinary rule which will be applied when the statute itself is silent upon the question. Primarily, then, it is a matter of construing the statute and in construing the statute the Court will have regard not only to its language, which may or may not touch upon the question, but also to the scope and purpose of the statute from which inferences may be drawn as to the legislative intention regarding the extent and the effect of the prohibition which the statute contains.

Thus in our view it may be stated as a general principle that a contract the making of which is prohibited by statute expressly or by implication, shall be void and unenforceable unless the statute itself saves the contract or there are contrary intentions which can reasonably be read from the language of the statute itself.

In *Menaka v. Lum Kum Chum* [1977] 1 MLJ 91 the Privy Council heard an appeal from a majority decision of the then Federal Court which held that the agreement in that case was forbidden by s. 8(b) of the Moneylenders Ordinance 1951 and therefore void. Section 8 of the Moneylenders Ordinance provided that if any person takes out a licence in any name "other than his true name" or carries on business as a moneylender in any name "other than his authorised name" the person shall be guilty of an offence under the Ordinance. Lord Fraser of Tullybelton in his speech stated that s. 8 of the Moneylenders Ordinance **penalises and by implication prohibits** the activities therein specified. For that reason their lordships were of the opinion that the appellant contravened s. 8(c) of the Ordinance.

The Privy Council then referred to the general rule as stated by Parke B. in *Cope v. Rowlands* [1836] 2 M & W 149, 157:

> It is perfectly settled, that where the contract which the plaintiff seeks to enforce ... is expressly or by implication forbidden by the common or statute law, no Court will lend its assistance to give it effect. It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies prohibition.

Lord Fraser in *Menaka* concluded that their Lordships were of the opinion that the contract and security having been made in contravention of s. 8 of the Ordinance were enforceable. The contract was also void under s. 2(g) of the Contracts (Malay States) Ordinance 1950.

Thus it is also a principle established by these authorities that where it is shown that a contract is void because it is prohibited by statute, the Court as a general rule should not lend its assistance to enforce the contract.

We now come to s. 24 of our Contracts Act 1950. The relevant parts of s. 24 of the Act read as follows:

> the consideration or object of an agreement is lawful unless:
>
> (a) it is forbidden by a law;
>
> (b) it is of such a nature that, if permitted, it would defeat any law;
>
> (c) ...
>
> (d) ...
>
> (e) the Court regards it is immoral, or opposed to public policy.

In each of the above cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.

From the authorities it would also seem clear that in considering illegality under the common law that question of public policy is often considered.

Lord Wright in *Vita Food Products Inc. v. Unus Shipping Co. Ltd.* [1939] 1 All ER 513 said at p. 523:

> Each case has to be considered on its merits. Nor must it be forgotten that the rule by which contracts not expressly forbidden by statute or declared to be void or in proper cases nullified for disobedience to a statute is a rule of public policy only, and public policy understood in a wider sense may at times be better served by refusing to nullify a bargain save on serious and sufficient grounds.

That is the position in common law. But the Courts in this country are bound by the statutory provisions of our Contracts Act.

The provisions of s. 24 of our Contracts Act referred to earlier are explicit statutory injunctions. The statute provides expressly that the considerations or objects referred to in paras. (a), (b) and (e) of s. 24 shall be unlawful and the agreement which ensues shall be unlawful and void. Paragraph (a) deals with what is forbidden or prohibited by law; para. (b) deals with what could defeat the object of any law; and para. (e) deals with public policy.

Section 3 of the Civil Law Act 1956 directs the Courts to apply the common law of England only in so far as the circumstances permit and save where no provision has been made by statute law. The development of the common law after 7 April 1956 (for the States of Malaya) is entirely in the hands of the Courts of this country. We cannot just accept the development of the common law in England. See also one of the majority judgments in *Government of Malaysia v. Lim Kit Siang* [1988] 2 MLJ 12 at p. 40.

The provision of s. 24 of our Contracts Act is a statutory direction. It may well have originated from some old common law principle but that principle has now been converted into a statutory provision.

We are therefore unable to accept the submission of Mr. Puthucheary that we follow what he termed as the "trend" shown by the Courts in common law countries to be slow in striking down illegal contracts because that contention is untenable on the face of the statute law of this country.

Paragraphs (a), (b) and (e) of s. 24 of the Contracts Act should be read disjunctively. Section 24 of the Contracts Act is explicit and that if an agreement is forbidden by law or prohibited by law or of such nature that it would defeat the law, that agreement is unlawful and void.

If the agreement is prohibited by law or forbidden by law or of such nature that it would defeat the law then the question of public policy does not arise at all. The question of public policy arises only in para. (e) where the Court considers an agreement to be immoral or otherwise opposed to public policy.

Mr. Puthucheary for the bank then urged us to construe s. 67(6) (formerly s. 67(4) of the Companies Act as a saving provision to sustain the claim of the bank. Section 67(6) reads as follows:

> 67(6). Nothing in this section shall operate to prevent the company from recovering the amount of any loan made in contravention of this section or any amount for which it becomes liable on account of any financial assistance given in contravention of this section.

According to Mr. Puthucheary, s. 67(6) should be divided into two limbs. The first limb provides that nothing in s. 67 shall prevent the company from recovering the amount of any loan made by the bank to purchasers in contravention of the section. The second limb provides that the section shall not prevent the company from recovering any amount for which it may become liable on account of any financial assistance given in contravention of the section. The words "for which it becomes liable" in s. 67(6), Mr. Puthucheary submitted, would mean that the company's liability to third parties remain unaffected by the prohibition contained in that section.

We find it difficult to agree with the construction proffered by Mr. Puthucheary. Firstly we have to look at the object of s. 67 of the Companies Act. The primary object is clearly to protect the company and no others. Section 67 of the Companies Act is designed to prevent the assets of a company from being misused. See *Wallersteiner v. Moir* [1974] 3 All ER 238 where Lord Denning MR at p. 238 said that s. 54(1) of the Companies Act 1948 was enacted to deal with a mischief which was described by Lord Greene MR in *Re VGM Holdings Ltd.* [1942] 1 All ER 225 at p. 225:

> Those whose memories enable them to recall what had been happening for several years after the last war will remember that a very common form of transaction in connection with companies was one by which persons - call them financiers, speculators, or what you will - finding a company with a substantial cash balance or easily realisable assets, such as war loan, bought up the whole, or the greater part, of the shares of the company for cash, and so arranged matters that the purchase money which they then become bound to provide was advanced to them by the company whose shares they were acquiring, either out of its cash balance or by realisation of its liquid investments. That type of transaction was a common one, and it gave rise to great dissatisfaction and, in some cases, great scandals.

Therefore the scope of s. 67(6) of the Act is confined only to the protection of the company and no one else.

The words "recovering the amount of any loan made in contravention of this section" in s. 67(6) can only mean any loan made by the company itself. The intention of the legislature is made clear in the explanatory statement to the bill when it was presented to Parliament. The notes on s. 67 stated that subclause (4) (now subclause (6)) "is designed to preserve the **rights of the company to recover loans** made in contravention of the provisions of this clause." The company there includes the subsidiaries. The explanatory notes went on to say that it was wrong to punish the company and the shareholders because of the default of the company's officers.

On the question of the securities and the guarantees the learned Judge dealt with them in his grounds of judgment at p. 32 as follows:

In the circumstances of the case, the plaintiffs had undoubtedly given financial assistance to the defendants as purchasers of the hotel's shares by the provision of the security on its assets and properties. There were also guarantees by the defendant directors. In *Selangor United Rubber v. Craddock (No. 3)* [1968] 2 All ER 1073 in construing s. 54 of English Companies Act, Ungoed-Thomas J at p. 1153 in holding that the securities invalid says:

> ... the security is the means of giving financial assistance within the meaning of the section ... Indeed the greater the invalidity the greater the assistance because the less liability to repay.

Further at p. 1154, he says:

> That to destroy the security which may be for very large amount is out of all proportion to the 100 pounds fine imposed by s. 54. This is a common well-recognised consequence accepted by the Courts in cases of transactions being made unlawful and participants being subjected to relatively light criminal punishment. That such provisions might prove a positive boon to the principal offenders has been similarly accepted on the well-accepted ground of public policy that the Courts will not aid unlawful transactions but let the consequences fall where they lie.

In applying the same principle in *Heald v. O'Connor* [1971] 2 All ER at p. 1109, Fisher J says:

> The apparent injustice which is the common result of the statutory prohibition of these particular kinds of transaction is not sufficient warranty for declining to apply the well-settled principle of law. The application of this principle in such circumstances as the present is likely to deter potential lenders from lending money on security which might be held to contravene the Act ...

In that case, Fisher J was considering the validity of a security created by a floating charge on the assets of the company providing loan to the defendant to purchase its shares in the company and endorsed with a personal guarantee signed by the defendant contrary to s. 54 of the English Companies Act [1948]. He held that the debenture in that case was prohibited by statute and for the reason illegal and the guarantee was also void and unenforceable.

Section 54 of the English Companies Act is substantially similar to the Australian Companies Act 1961 s. 67 (see *Carney v. Herbert & Ors.* [1985] All ER 438) and of course our s. 67 is modelled on the Australian. In these circumstances, I accept the principle of the English version of s. 54 and hold that the securities here are equally invalid, and unenforceable as contrary to public policy.

We agree with the conclusion and have nothing to add.

What is important to note here is that the bank had knowledge of the illegality. It is clear from the various affidavits of Chuah Chong Lim, at one time the manager of the Johor Bahru branch of the bank, that the bank was fully aware of the nature of the transaction. In his affidavit dated 25 November 1986 in originating summons no. 31-213 of 1986, there were blatant admissions of the nature of the transaction. Paragraph 11 of the affidavit states:

> Further, I am reliably advised and verily believe that in so far as the plaintiffs as bankers are concerned, it was not unlawful for the plaintiffs to grant a loan of RM1,250,000 to Syarikat Johore Tenggara Sdn. Bhd., for it to purchase the shares of the 1st defendant herein and for the 1st defendant to charge its property comprised in Malay Grant No. 1569 for Lot 1327 situated in the Township of Johore Bahru, District of Johore Bahru, State of Johore by way of security.
>
> (AR Vol. I, p. 130)

On the second loan the affidavit in para. 17 states:

> I admit that both the principal and supplemental charges were created by the 1st and 2nd defendants respectively to secure the payment of banking facilities of RM4,000,000 consisting of RM1,500,000 by way of overdraft facilities and RM2,500,000 by way of term loan granted by the plaintiffs to the 1st defendant in accordance with their letter of offer dated 28 September 1982. One of the terms was that out of the term loan of RM2,500,000 the 1st defendant should utilise RM1,250,000 to pay to the plaintiffs so as to liquidate the debt owed by its sister company, Syarikat Johore Tenggara to the plaintiffs and I further admit that the said sum was duly paid by the 1st defendant to the plaintiffs for the liquidation of the indebtedness of its sister company the said Syarikat Johor Tenggara Sdn. Bhd.
>
> (AR Vol. I, p. 135)

To answer the broad questions referred to earlier we are of the view that the two loans granted by the bank in 1980 and 1982 should be regarded as one continuous transaction. The 1980 loan was clearly a loan to deal in the shares of the hotel. The 1982 term loan dealt also with the liquidation of the 1980 fixed loan. The securities used are the same securities belonging to the hotel and its subsidiary. Thus the two loans are really indistinguishable in character. They should in fact be properly regarded as one continuous transaction. The 1980 loan was clearly a transaction prohibited by statute and the 1982 loan was tainted with illegality.

This brings us finally to the question of the doctrine of severance which is the last alternative argument of the bank if their other arguments failed.

Mr. Puthucheary, as far as we understood him, conceded that the first loan was in contravention of s. 67 of the Companies Act but contended however that the securities and guarantees were severable and enforceable. Severance is thus a crucial question but Mr. Puthucheary was seeking to argue it before us for the first time. We were thus promptly reminded by Mr. Choo (Counsel for the respondents) that the issue of severance was never argued in the Court below and neither was it mentioned anywhere in the pleadings.

What is the nature of the principle which Mr. Puthucheary is urging us to apply here? In regard to the doctrine of severance two principles would seem to have been established. Firstly, each case must be considered on its own facts. There is no set rules to follow in all cases. To some extent each case must depend on its own circumstances and on the nature of the illegality itself. Secondly, the consideration of public policy plays an important role. See the speech of Lord Brightman in *Carney v. Herbert* [1985] 1 All ER 438.

Muniandy & Anor. v. Muhammad Abdul Kader & Ors. [1989] 2 MLJ 418 is the most recent local authority on the question of the reception of a ground of appeal on a point not argued in the Court below nor set out in the pleadings.

In *Muniandy* what the appellants wanted to introduce and argue was a fresh point not pleaded or argued in the Court below that as owners of a plank house the appellants had an equitable interest in the land and were therefore not trespassers. In rejecting the application Mohd. Azmi SCJ on behalf of this Court stressed on the importance of adhering to pleadings at p. 418:

> Unless the objection raised is merely technical, the importance of pleadings can be found in many authorities. The most instructive is perhaps by Lord Diplock in *Hadmor Productions v. Hamilton* [1983] 1 AC 191 (refd) at p. 233:

> Under our adversary system of procedure for a Judge to disregard the rule by which Counsels are bound, has the effect of depriving the parties to the action of the benefit of one of the most fundamental rules of natural justice, the right of each to be informed of any point adverse to him that is going to be relied upon by the Judge, and to be given the opportunity of stating what his answer to it is ...

The crucial issue of the application of doctrine of severance should have been pleaded and argued before the learned Judge and it would be wrong in our view to allow the alternative ground of appeal to be argued at this late stage.

In a case of this nature the position at common law is neatly explained in *Chitty on Contracts*, Vol. I, 23rd Edn. at para. 808:

> Neither party can sue upon a contract if:
>
> (a) both knew that it necessarily involved the commission of an act which, to their knowledge, is legally objectionable, that is illegal, immoral or otherwise against public policy, or
>
> (b) both knew that the contract is intended to be performed in a manner which, to their knowledge is legally objectionable in that sense, or
>
> (c) the purpose of the contract is legally objectionable and that purpose is shared by both parties.

In dealing with s. 23 of the Indian Contracts Act (s. 24 of our Contracts Act), the Indian Supreme Court did not show any sympathy on the party who deliberately made use of a contract to circumvent the law. In *Firm, Pratapchand v. Firm, Kotrike* AIR [1975] SC 1223 the Indian Supreme Court held that:

> If an agreement is merely collateral to another or constitutes an aid facilitating the carrying out of the object of the other agreement which, though void, is not in itself prohibited, within the meaning of s. 23 of the Contract Act, it may be enforced as a collateral agreement. If, on the other hand, it is part of a mechanism meant to carry out what the law has actually prohibited, Courts will not countenance a claim based upon the agreement because it will be tainted with an illegality of the object sought to be achieved which is hit by s. 23 of the Contract Act. It is well established that the object of an agreement cannot be said to be forbidden or unlawful merely because the agreement results in what is known as void contract. A void agreement, when coupled with other facts, may become part of a transaction which creates legal rights, but this is not so if the object is prohibited of "*mala in se*."

In *Patriot Pte. Ltd. v. Lam Hong Commercial Co.* [1980] 1 MLJ 135 the Court of first instance in Singapore held that the "whole operation was designed expressly by the parties herein and the Indonesian buyer to evade Indonesian Customs duties" and dismissed the appellants' claim on the ground that the contract between the parties was illegal and void. On appeal to the Court of Appeal it was held that if a party to a contract actively engages in an illegal adventure to get goods into a country in breach of the revenue laws of that country, the Court will not assist the parties to the adventure by entertaining or settling any dispute between the parties arising out of the contract.

In this case the parties are not like the parties in *Menaka*. Surely we can assume that no bank will enter into an agreement without the benefit of legal advice. In the circumstances the bank was clearly implicated in the illegality and was indeed party to an agreement to defeat the object of a statute and should accordingly be precluded from suing upon it - *ex turpi causa non oritur actio*. It matters not, as Lindley LJ said "whether the defendant has pleaded the illegality or whether he has not."

Our answers to the points raised by the bank are therefore as follows:

(a) The object of s. 67 of the Companies Act is to save the company and no one else;

(b) The rationale behind s. 67(6) of the Act is to preserve the right of the company to recover any loan made by it in contravention of that section;

(c) Section 24 of the Contracts Act 1950 is an explicit statutory direction and must be applied by our Courts;

(d) Because the principle of the common law has been incorporated into statutory law as contained in s. 24 of the Contract Act the trend or any change in the common law elsewhere is not relevant. Any change in the common law after 7 April 1956 shall be made by our own Courts.

(e) Since the doctrine of severance is to be applied according to the facts of each case and that to some extent each case must depend on its own circumstances and on the nature of the illegality itself, the application of the doctrine of severance should have been pleaded and argued in the Court of first instance and not at this late stage.

The appeal is accordingly dismissed. Having regard to the circumstances of this case we order that parties shall bear their own costs here and below.

Also found at [1990] 1 CLJ 675